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SUBJECT: AUSTRIAN AIRLINES REDUCES SERVICE TO U.S., SEARCH FOR  
STRATEGIC PARTNER ON HOLD

REF: (A) VIENNA 0965; (B) VIENNA 0871; (C) VIENNA 0675;  
(D) VIENNA 0395

Summary

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[¶1.](#) Austrian Airlines' (AUA) will stop service to Chicago, reduce frequencies of flights to New York, Washington and other long-haul and Western European destinations, and increase the fuel surcharge. The GoA collapse puts AUA's search for a strategic partner on hold. The delay in the privatization decision could become problematic for AUA, since the previously projected loss of up to Euro 90 million for 2008 looks likely to be much higher, draining AUA's cash reserves of about Euro 200 million. However, the final decision on AUA's future most likely will have to wait for the new GoA, which is expected to take office between the end of November and early 2009. End Summary.

AUA's Cost-Cutting Stops Service to Chicago

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[¶2.](#) In a cost-cutting effort, AUA will stop service to Chicago as of October 25 and from mid-January to end-March 2009 reduce the number of flights to Washington from seven to six per week and to New York from six to five. AUA will also reduce service to Mumbai and cut or reduce seasonal frequency to other destinations in Western Europe. AUA's route network in the growth markets of Central and Eastern Europe and the Middle East will not be affected. According to AUA CEO Alfred Oetsch, this will result in a 21% cut in production (measured in available seat kilometers) on the North Atlantic routes, a 5% cut in overall production, and the use of three fewer aircraft in 2009.

[¶3.](#) As of July 15, 2008, AUA increased its fuel surcharge for short- and medium-haul flights from Euro 24 to 27, and for long-haul flights from Euro 92 to 98. Further, in reaction to the continued uncertain oil markets, AUA, which now hedges 20% of its annual kerosene requirement with forward contracts, announced an expansion of its hedging strategy by securing the rest of its annual fuel requirement with call options.

GoA Collapse Puts AUA's Strategic Partner Search on Hold

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[¶4.](#) The collapse of the GoA (ref A) puts AUA's search for a strategic partner on hold. Since mid-June AUA officially has been looking for a strategic partner and OIAG, the GoA's holding company and majority owner of AUA, hired the Boston Consulting Group (BCG) to work out a detailed recommendation for a strategic partner (ref B) and Merrill Lynch to find a buyer. BCG is expected to produce an

interim report by the end of July, at which time AUA will publicize its results for the first half of 2008, which due to a "not so good" second quarter could be a negative surprise. Some experts feel that the loss of up to Euro 90 million for 2008, projected only two months ago, could be considerably higher.

¶5. An AUA source confirmed that the outgoing GoA has not yet formally authorized OIAG to sell its shares in AUA. Plans for taking this decision in an August 6 cabinet meeting seem shaky because of different opinions between the ruling OVP and SPO and within the SPO. The OVP supports seeling all but a blocking minority of 25% plus one share, while the SPO generally woud prefer to block privatization. Transport Minister Werner Faymann, nominated as the SPO candidate for Chancellor, who seemed open to "reasonable solutions," is under increasing pressure from other prominent SPO reps to pursue a strict anti-privatization course. Thus, a final decision on AUA's future most likely will have to wait for the new GoA, which is expected to take office no earlier than the end of November 2008, but more likely in early 2009.

Comment

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¶5. The GoA collapse creates a highly uncomfortable situation for AUA. The airline does not seem to be on the verge bankruptcy, with sufficient liquidity to survive the rest of the year and into 2009. However, political factors that seem likely to delay the search for a strategic partner for half a year will make the situation worse for AUA and depress its price, since AUA's financial situation is unlikely to improve significantly in the near future.

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